

Message Text

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ACTION EA-10

INFO OCT-01 EUR-12 ISO-00 SAJ-01 SP-02 AID-05 EB-07 NSC-05

CIEP-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-07 NSAE-00 XMB-04 OPIC-06 LAB-04

SIL-01 DODE-00 PM-03 H-02 L-02 PA-02 PRS-01 USIA-15

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R 280120Z FEB 75

FM AMCONSUL HONG KONG

TO SECSTATE WASHDC 3963

INFO AMEMBASSY LONDON

UNCLAS SECTION 1 OF 2 HONG KONG 2098

E.O. 11652: N/A

TAGS: EFIN HK

SUBJECT: ANNUAL BUDGET SPEECH: TIDING OVER HARD TIMES

SUMMARY: THE FINANCIAL SECRETARY (FS) PRESENTED THE 1975/6 BUDGET TO LEGCO ON FEBRUARY 26. IT ASSUMES NO REAL GROWTH FOR GDP IN THIS PERIOD, FOLLOWED BY A RAPID RESURGENCE OF ECONOMIC ACTIVITY IN 1976. EXPENDITURES HAVE BEEN PARED SEVERELY PARTICULARLY IN THE CAPITAL BUDGET BUT THE ESSENTIALS OF THE GOVERNOR'S PROGRAMS IN HOUSING, EDUCATION, AND SOCIAL WELFARE ARE PROVIDED FOR. A PROJECTED DEFICIT OF HK\$830 MILLION HAS BEEN PARTIALLY FILLED BY A WIDE ASSORTMENT OF INDIVIDUALLY MODEST TAX AND FEE INCREASES; THE REMAINDER IS TO COME FROM, CHIEFLY FOREIGN, BORROWING. EXPECTING A BIGGER TAX BITE, THE PUBLIC GREETED THE SMALL INCREASES WITH A SENSE OF RELIEF. END SUMMARY.

1. HONG KONG HAS HAD THREE DEFICITS UP TO 1974. THE CURRENT FINANCIAL YEAR WILL PRODUCE THE FOURTH, ABOUT HK\$410 MILLION, AND FY 1975/6 WILL PRODUCE THE FIRST
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PLANNED DEFICIT. ORIGINAL DEPARTMENTAL ESTIMATES

(BASED UPON THE FLATTENING REVENUE CURVE OF EXISTING TAXES) WOULD HAVE PRODUCED A DEFICIT OF HK\$2,268 MILLION (I.E. 96 PERCENT OF THE COLONY'S RESERVES). IN TWO ROUNDS OF CUTS, EXPENDITURE PLANS WERE REDUCED BY HK\$1,442 MILLION TO HK\$6.6 BILLION (US\$1.4 BILLION). MUCH OF THIS CAME OUT OF PUBLIC WORKS, BUT THE GOVERNOR'S 10-YEAR PROGRAM FOR NEW HOUSING IS ONLY SLIGHTLY RETARDED WHILE THE EDUCATION DEPARTMENT IS PROCEEDING WITH PLANS FOR 19,000 NEW SECONDARY SCHOOL PLACES IN THE COMING YEAR.

2. IN COMMENTING UPON THE STATE OF HONG KONG'S EXPORT-LED ECONOMY, HE SAID FOREIGN DEMAND SHOULD PICK UP BEFORE THE END OF 1975 BUT THAT THE ECONOMIC DECLINE IN THE FIRST HALF WILL BE SUCH THAT THE YEAR WILL SEE NO GROWTH IN GDP AND EVEN POSSIBLY A SMALL DECLINE. ON THE OTHER HAND, 1976 WILL SEE RAPID GROWTH AND IT IS IMPORTANT FOR THE GOVERNMENT TO MAINTAIN A CONSISTENT PATTERN OF EXPENDITURE TO AVOID DISLOCATION.

3. THE BUDGET SPEECH WAS A DISPLAY OF ENGLISH PRAGMATISM OF THE SORT THAT CAUSES GERMANS TO DECRY THE LACK OF ORDER AND SYSTEM ON THE PART OF ANGLO SAXONS AND THE FRENCH TO SHOUT "PERFIDIOUS ALBION." THE FS POINTED TO A PROBABLE DEFICIT WHICH COULD NOT BE FILLED BY ANY ONE OF THE FOLLOWING METHODS: (1) DRAWING DOWN RESERVES -- THIS WOULD SAP THE CREDIT OF THE COLONY; (2) BORROWING -- THIS WOULD INVOLVE FISCAL AND MONETARY RISKS; (3) SUBSTANTIAL TAX INCREASES -- THEY WOULD DAMAGE THE ECONOMY. SINCE NO ONE OF THESE METHODS WOULD WORK, THE FS PROPOSED A LITTLE OF EACH. TAXES AND FEES WOULD BE RAISED MODERATELY; A LIMITED AMOUNT OF BOTH DOMESTIC AND FOREIGN BORROWING (HK\$429 MILLION) WOULD BE USED TO CLOSE THE GAP; AND, IF THE GAP PERISTS, A SMALL PORTION OF THE RESERVES WILL BE USED.

4. REVENUES: PENDING A FULL-SCALE REVIEW OF INCOME TAXES, TENTATIVELY SCHEDULED FOR 1976, AND A NEW WITHHOLDING TAX ON DIVIDENDS ALSO SCHEDULED FOR 1976, THE FS MADE A SERIES OF MODEST REVENUE PROPOSALS DESIGNED TO RAISE

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HK\$467 MILLION.

A. DIRECT TAXES:

- (1) AN INCREASE OF THE CORPORATE PROFITS TAX FROM 15 PERCENT TO 16.5 PERCENT FOR ONE YEAR ONLY. THIS IS TO BE REPLACED BY A TAX ON DIVIDENDS.
- (2) FOR PURPOSES OF TAXING QUARTERS PROVIDED BY EMPLOYERS AS INCOME, THESE WILL BE ASSESSED

AS 10 PERCENT OF TOTAL SALARY VICE FORMER
FIGURE OF 7.5 PERCENT.
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ACTION EA-10

INFO OCT-01 EUR-12 ISO-00 SAJ-01 SP-02 AID-05 EB-07 NSC-05

CIEP-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00

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TO SECSTATE WASHDC 3964
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UNCLAS SECTION 2 OF 2 HONG KONG 2098

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SUBJECT: ANNUAL BUDGET SPEECH: TIDING OVER HARD TIMES

(B) INDIRECT TAXES:
(1) DUTY ON HORSE RACE BETTING WILL BE RAISED
BY AN UNSPECIFIED AMOUNT TO RAISE AN ADDI-
TIONAL HK\$27 MILLION.
(2) RATES (PROPERTY TAXES) WILL BE RAISED BY
2.5 PERCENT. THESE VARY BY LOCATION, BUT
FOR PRIME DOMESTIC AND COMMERCIAL PROPERTY
ON HONG KONG ISLAND WILL BE 17.5 PERCENT.
(3) DUTIES ON INTOXICATING LIQUORS RAISED BY
HK\$6 PER GALLON ON SPIRITS AND 10 ERPCENT
ON WINES.
(4) DUTIES ON TOBACCO AND TOBACCO PRODUCTS
RAISED BY 25 PERCENT.

(5) STAMP DUTIES ON BOTH BANK CHECKS AND TRAVELLERS' CHECKS RAISED TO 30 CENTS.

(6) AD VALORUM DUTY ON DEEDS AND CONVEYANCES
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RAISED FROM 2 PERCENT TO 2.25 PERCENT.

(7) ENTERTAINMENT TAX ON MOVIE ADMISSIONS, ABOLISHED IN 1973, REINSTITUTED ON SLIDING SCALE.

C. FEES FOR GOVERNMENT SERVICES:

(1) ANNUAL BUSINESS REGISTRATION FEE RAISED FROM HK\$50 TO HK\$150.

(2) ANNUAL COMPANIES REGISTRATION FEE RAISED FROM HK\$100 TO HK\$300.

(3) FEE FOR TRAVELLERS USING MACAU FERRY TERMINAL RAISED FROM 50 CENTS TO HK\$5. PER JOURNEY.

(4) BUOY CHARGES RAISED TO HK\$600 PER DAY FOR A BUOYS; HK\$400 FOR B BYOYS. ANCHORAGE FEES RAISED TO HK\$12 PER 100 TONS.

(5) ANNUAL BANK LICENCES RAISED FROM HK\$40,000 PLUS HK\$1,000 PER BRANCH TO HK\$200,000 PLUS 10,000 PER BRANCH.

(6) DEPOSIT TAKING FINANCE COMPANIES TO PAY ANNUAL FEE OF HK\$10,000.

(7) AIRPORT LANDING FEES TO BE RAISED BY 15 PERCENT WITH A SURCHARGE OF HK\$500 FOR MOVEMENTS DURING PEAK TRAFFIC HOURS.

(8) POSTAGE FOR LOCAL LETTERS RAISED FROM 10 CENTS TO 20 CENTS PER OUNCE.

(9) WATER CHARGES FOR HOUSEHOLDS USING MORE THAN 16,700 GALLOS PER QUARTER RAISED TO HK\$6 PER THOUSAND GALLONS. NO RISE FOR INDUSTRIAL USERS.

(10) EXPORT LICENCES FOR TEXTILE PRODUCTS WILL COST HK\$15.

5. BORROWINGS: THE FS SAID HONG KONG WILL HAVE TO BORROW ABOUT HK\$360 MILLION. HE SUGGESTED THAT THE UPPER LIMIT OF BORROWING SHOULD BE SET BY SERVICING CHARGES OF HK\$300 MILLION PER ANNUM WHICH IS THE NET INTEREST EARNING FROM HKG INVESTMENTS AND DEPOSITS, EXCLUDING THE EXCHANGE FUND. MOST BORROWING WILL PROBABLY BE FOREIGN TO AVOID AFFECTING LOCAL INTEREST RATES. ACTIVE CONSIDERATION IS BEING GIVEN TO THE ISSUANCE OF TREASURY BILLS.

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6. RESERVES: THE BUDGET DOES NOT ENVISAGE RUNNING DOWN RESERVES, BUT PRESUMABLY THEY WOULD BE USED IN A PINCH. FISCAL RESERVES ARE ESTIMATED AT HK\$2,371 MILLION ON APRIL 1 (END OF THE FINANCIAL YEAR); THIS IS A DROP OF HK\$511 MILLION FROM APRIL 1974 AND EQUALS ABOUT FOUR MONTHS OF GOVERNMENT EXPENDITURE.

7. FISCAL POLICY: THE FS CHARACTERIZED THE BUDGET AS RELATIVELY EXPANSIONARY. TO HAVE FURTHER REDUCED EXPENDITURE WOULD HAVE REDUCED THE GDP BY 1.5 PERCENT.

8. REACTION: THE GENERAL INITIAL REACTION WAS ONE OF RELIEF. THE HKG HAD LEAKED SO MUCH GLOOMY ECONOMIC NEWS OF LATE THAT MOST BUSINESSMEN WERE RESIGNED TO THE PROSPECT OF DRACONIAN MEASURES AND WERE PLEASANTLY SURPRISED BY THE MODEST INCREASE IN THE TAX BITE. BOTH CHINESE AND ENGLISH LANGUAGE PAPERS GAVE THE BUDGET GOOD MARKS. IN THE LONGER RUN, WE ANTICIPATE A GROWING OPPOSITION TO THE FORTHCOMING TAX REVIEW, AT LEAST BY THOSE WHO WISH TO KEEP HONG KONG SAFE FOR MILLIONAIRES.
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